# Internal Revenue Service memorandum CC:TL-N-5343-88

Br4:JTChalhoub

date: MAY 16 1988

to: District Counsel', Saint Paul MW:STP

Attn: J. Schmittdiehl

from: Director, Tax Litigation Division CC:TL

subject:

; Validity of Assessment

This will confirm our informal technical advice concerning the validity of an assessment made by the Ogden Service Center for the tax year for the above-described taxpayer.

## ISSUE

Under Treas. Reg. § 301.6211-1(a), if the Service accepts for filing an amended return on which the taxpayer reports increases, both in income and deductions, may the Service validly assess without resort to deficiency procedures an amount higher than the increase in tax reported on the amended return by totally disregarding the deductions and computing the tax assessed on the increased income reported?

## CONCLUSION

Treas. Reg. § 301-6211-1(a) provides, in relevant part, as follows:

Any amount shown as additional tax on an "amended return," so-called (other than amounts of additional tax which such return clearly indicates the taxpayer is protesting rather than admitting) filed after the due date of the return, shall be treated as an amount shown by the taxpayer "upon his return" for purposes of computing the amount of a deficiency.

This provision of the regulations was added in 1977 by TD 7498, 1977-2 CB 473. The regulation applies exclusively to the amount of additional tax reported on the amended return and not to the amount of income or deductions reported on the amended return. Accordingly, the assessment of \$ was invalid and the correct assessment on \$ should have been \$ Under the circumstances, we recommend you file a motion for leave to amend the answer to claim an increased deficiency in the amount of \$ was soon as possible.

#### FACTS

We will recite facts some of which appear to be unclear and irreconcilable with the information you submitted from the administrative file. Consequently, we will include facts discussed informally with John Schmittdiehl of your office and make certain assumptions based upon that information.

signed their original Taxpayers and We assume it was filed with the return on Service shortly thereafter. The original return does not reflect any net operating loss. On taxpayers filed an amended return and an amended return claiming a net operating loss carryback from a business venture, a retail liquor store. On the amended return for the taxpayers reported \$ as additional and claimed a deduction of \$ from the failed as additional from the failed business venture. The amended return for does not indicate a claim for refund, but rather additional tax due in the amount . A Form 1045, Application for Tentative Refund, is included in the package of materials purportedly filed with the amended returns, but the form is unsigned and undated. We accordingly do not consider that document in connection with the request for technical advice.

The transcript of account for reflects a subsequent payment entry, dated for for the administrative file reflects a Form 1040X for the date stamped at the Ogden Service Center on the include a Form 1040X for in that package. However, we assume an amended return was included for the decay an acknowledgment letter in the administrative file from the Ogden Service Center, dated May 20, 1983, and that letter refers to a "claim" on Form 1040X for the option of the

A letter dated June 16, 1983, from the Chief, Correspondence Section, Ogden Service Center, states as follows:

We have increased your Form 1040 as shown on your Form 1040X. We have not allowed the net operating loss carryback as there is none shown on your Form 1040.

You will receive a notice showing our adjustment action.

The copy of the amended return for attached to the Form 1040X in the administrative file indicates a loss on Schedule E of from , a Subchapter S corporation. Form 4797 attached to the amended return also indicates a seizure of cash in the amount of and a Section 1244 stock loss of for a total of in losses attributable to

Following the letter dated June 16, 1983, the Ogden Service Center assessed, on July 4, 1983, not \$ shown as due on the service amended return and paid with that amended return, but \$ A subsequent document in the administrative file, labeled AMENDED ÆETURN ACKNOWLEDGMENT, is dated June 20, 1983, and states as follows:

We will review your return as soon as possible. Since we have a large number of similar requests, it may take as long as 3 months before yours is processed. We apologize for any inconvenience this delay may cause you.

You will receive a notice from us regarding this tax year when the change has been completed.

If you have any questions, you may call or write us -- see information in the upper right corner. To make sure that IRS employees give courteous responses and correct information to taxpayers, a second IRS employee sometimes listens in on telephone calls.

This document indicates that prior to making the assessment on July 4, 1983, the Ogden Service Center had in its possession a copy of the amended return for showing a net operating loss for the year ...

The taxpayer is an admitted embezzler who has been convicted and served a term in jail. Another taxpayer, apparently an ex-lover, was also indicted and convicted of embezzlement. . The embezzlement took amount both embezzled was \$ place in and was discovered in . A substantial portion of the funds embezzled has been unaccounted for. Thus, when the Service examined the returns of the embezzlers, the notice of deficiency to each embezzler charged each with the total amount embezzled of \$ . Since an amended return had been filed by the admitting to one half the amount embezzled, the notice of deficiency to the seems 's for added only to income. The net operating loss deduction claimed has been disallowed and a deficiency has been computed as follows:

Total corrected income tax Total tax shown on return or as previously adjusted Deficiency



Fraud Penalty § 6653(b)

Both petitions from their respective notices of deficiency. The paramour alleges that got all the money embezzled so the cases were consolidated for trial, briefing and opinion. has pleaded allowance of a net operating loss deduction for . A trial has been held, the briefs were filed in and the case is presently awaiting an opinion. Apparently, the Collection Division is attempting to collect the original assessment from in the amount of plus interest. When the matter was brought to District Counsel's attention, the question was raised whether the original assessment in the amount of was valid or whether of that assessment should have been subject to deficiency procedures.

#### DISCUSSION

Section 6211(a) of the Code defines the term deficiency to mean the amount by which the tax exceeds the excess of

- (1) the sum of
- (A) the amount shown as the tax by the taxpayer upon his return...plus
- (B) the amounts previously assessed (or collected without assessment) as a deficiency, over --
- (2) the amount of rebates...made.

Prior to amendment, Treas. Reg. § 301.6211-1(a) read, in part, as follows:

additional tax shown on an "amended return," so-called, filed after the due date of the return, is a deficiency within the meaning of the Code.

Based on the regulation before an amendment was made to read as indicated in the "conclusion" above, the Service determined that additional unpaid tax shown on an amended return was a deficiency subject to the restrictions on assessment and collection provided for in I.R.C. § 6213(a). Consequently, to legally assess a tax, which the taxpayer admitted he owed by

filing an amended return showing the tax due, even though it was not paid, the Service prior to 1977 had to use the statutory deficiency procedures. The regulatory change permitted the Service to do what it did not have authority to do before the adoption of Treasury Decision 7498; that is assess the amount of tax reported on an amended return and treat that assessment as an amount previously assessed for purposes of determining a deficiency.

Neither the regulation, as amended, nor the statute it seeks to interpret, permit the Service to independently accept or reject a portion of an amended return and disregard another portion of the return. The Ogden Service Center had the authority not to accept the amended return for filing. Once it accepted the return, it had the duty to process the amended return as filed. The fact that payment accompanied the amended return is further evidence that it should have assessed the amount reported as an increase in tax, viz. \$ \_\_\_\_\_\_.

In order to disallow the net operating loss deduction, the Ogden Service Center was obligated to make use of the deficiency procedures. The issue of whether a seizure of the assets of the business venture in the retail liquor store generated a net operating loss was an issue on which the taxpayer specifically declared his position in the amended return. It was error on the part of the Ogden Service Center to disallow the net operating loss deduction without employing the deficiency procedures.

Under the definition of the term "deficiency" in I.R.C. § 6211(a), as interpreted by the current regulation in effect in the Ogden service Center had no authority to recompute the tax reported as an increase on the amended return. Thus, the assessment on the meaning of I.R.C. § 6211(a)(1)(B) as an amount previously assessed "for purposes of computing the amount of a deficiency." Accordingly, we recommend the respondent file a motion for leave to amend the answer to claim an increased deficiency of \$ (\$ 1 test \$ 1 test \$

operating loss deduction pleaded in the petition at paragraphs 4b., 5c. and 5d. We do not believe the amendment to the answer alters the computation of the fraud penalty from the information provided.

> MARLENE GROSS Director

By:

Z.

Chief, Branch No. 4

Tax Litigation Division